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Investigating the Solutions and Challenges of Financing for Small Start-ups in Balkh Province, Afghanistan

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ABSTRACT

Small start-ups play a pivotal role in employment generation and economic innovation, particularly in fragile and conflict-affected states. However, access to appropriate financing remains a persistent barrier to their survival and growth. Afghanistan, characterized by limited banking infrastructure and high economic uncertainty, presents a unique but under-researched context for start-up financing. This descriptive, cross-sectional, applied study investigated the financing sources, selection criteria, challenges, and coping strategies of start-ups operating for less than three years in Balkh province, Afghanistan. Data were collected from 30 randomly selected start-ups using a structured questionnaire. Descriptive statistics and binomial tests (test proportion = 0.50, $\alpha = 0.05$) were employed for hypothesis testing. Personal capital was the predominant financing source (80%), followed by bank loans (20%); this proportion significantly exceeded 50% ($p = 0.001$). All respondents (100%) identified personal capital as the most preferred and least risky method ($p < 0.001$). While 60% of respondents identified the legality of the source as their primary selection criterion, and 60% identified insufficient personal capital as their main financing challenge, neither proportion differed significantly from 50% ($p = 0.362$ in both cases), and these findings should be read as descriptive trends rather than statistically confirmed majorities. In response to financial pressure, 60% reported reducing business activities (also not statistically significant, $p = 0.362$), whereas only 10% sold company assets a proportion significantly below 50% ($p < 0.001$). Financing decisions in Balkh province start-ups are driven by resource availability, risk avoidance, and reliance on owner-based capital, broadly consistent with the Pecking Order Theory. The study suggests a possible "financing trap" where capital scarcity reinforces conservative, low-growth strategies .Given the small sample size (N=30), findings should be interpreted with caution and may not generalize to all Afghan start-ups .Policymakers should develop guarantee schemes and micro-venture capital mechanisms. Future research should employ larger, multi-province samples and qualitative methods to explore the reasons for bank loan avoidance.

Keywords: Bank loans; Financing challenges; Personal capital; small start-ups; Pecking Order Theory

بسم الله الرحمن الرحيم

1. Introduction

اَلْحَمْدُ لِلّٰه نَحْمَدُهُ وَنَسْتَعِينُهُ وَنَسْتَغْفِرُهُ، وَنَعُوذُ بِاللّٰه مِنْ شُرُورِ أَنْفُسِنَا وَمِنْ سَيِّئَاتِ أَعْمَالِنَا، مَنْ يَهْدِهِ اللّٰهُ فَلاَ مُضِلَّ لَهُ، وَمَنْ يُضْلِلْ فَلاَ هَادِىَ لَهُ، وَأَشْهَدُ أَنْ لاَ إِلَهَ إِلاَّ اللّٰهُ وَحْدَهُ لاَ شَرِيكَ لَهُ، وَأَشْهَدُ أَنَّ مُحَمَّدًا عَبْدُهُ وَرَسُولُهُ. اما بعد:

1.1 Background

Asset growth is a fundamental indicator of business expansion and a meaningful signal of future performance. In corporate finance theory, understanding how assets are financed is as important as understanding the assets themselves, because financing decisions directly affect risk, return, and long-term viability (Brealey, Myers, & Allen, 2020). For start-ups defined as newly established ventures operating for less than three years, this analysis is particularly critical. A single financing mistake during the early stages can lead to venture failure, whereas appropriate financing strategies enhance survival and growth potential (Cumming & Johan, 2020).

In the current global business environment, entrepreneurial motivation has remained strong. Across both developed and developing economies, individuals continue to be motivated to establish private enterprises and pursue investment opportunities (Kerr & Nanda, 2022). This motivation is directly relevant to the challenges facing small start-ups: access to capital, limited bank credit, reliance on personal savings, and the scarcity of alternative financing sources issues that are especially pronounced in fragile economies such as Afghanistan. When financing is managed properly, it supports business growth, operational continuity, and value creation. Conversely, weak financial planning and inappropriate funding methods can prevent a company from achieving economic stability and may ultimately lead to failure (Bruton, Ahlstrom, & Si, 2021).

1.2 Problem Statement

Despite the recognized importance of appropriate financing, many start-ups, particularly in fragile and conflict-affected economies, face severe constraints in accessing capital. The World Bank has repeatedly identified access to finance as one of the most frequently cited obstacles to growth for small businesses in low-income and fragile economies (World Bank, 2023). This constraint is especially acute in Afghanistan: World Bank Enterprise Survey data confirm that access to finance remains the number one obstacle reported by both small and large firms, with banks financing less than one percent of firms' working capital (World Bank, 2025). The situation is further exacerbated by a fragmented banking sector, high economic uncertainty following political transitions,

weak legal protections for creditors, and the absence of formal venture capital markets (World Bank, 2023).

Balkh province, with Mazar-i-Sharif as its economic center, is one of Afghanistan's more commercially active regions. However, even here, newly established companies struggle to secure financing. Anecdotal reports from local business advisors suggest that most start-ups rely on personal savings or family support, while formal credit mechanisms remain underutilized a pattern this study aims to empirically verify. The reasons for this pattern whether due to high interest rates, collateral requirements, risk aversion, or lack of financial literacy- have not been systematically investigated.

Therefore, the central problem addressed by this study is: How do newly established companies in Balkh province finance their operations, what challenges do they face in securing financial resources, and what strategies do they employ to cope with financing constraints? Answering these questions is essential for entrepreneurs, policymakers, and financial institutions seeking to support small business development in fragile economies.

1.3 Research Gap

Although a substantial body of literature exists on start-up financing in developed economies (Gompers & Lerner, 2001), research in fragile and conflict-affected states remains scarce. This study addresses several specific gaps in the existing literature.

First, a geographic gap exists because little empirical study has examined start-up financing in Afghanistan, a prototypical fragile state characterized by institutional weakness and economic volatility. While recent research has examined business environment reforms in fragile and conflict-affected states more broadly (Luiz, Ganson, & Wennmann, 2019), start-up-level financing behavior within these environments and in Afghanistan specifically remains largely unexamined.

Second, a contextual gap is evident, as existing research assumes functioning banking systems, enforceable contracts, and legal protections for creditors — assumptions that do not hold in the Afghan context.

Third, a methodological gap arises because prior studies in neighboring countries, such as Karimi (2013) in Iran, focused on established SMEs rather than newly created start-ups operating for less than three years, whose financing behavior may differ systematically.

Fourth, a theoretical gap remains, as the applicability of dominant finance theories, including Pecking Order Theory and Trade-off Theory, in a context of extreme uncertainty has not been empirically tested.

This study is among the first empirical studies to systematically investigate financing solutions and challenges among newly established companies in Balkh province, Afghanistan.

1.4 Significance of the Study

This research is significant for four primary reasons.

First, financing decisions directly shape the growth and sustainability of new businesses. Many start-ups fail not because of weak ideas or incompetent management, but because they lack access to appropriate financial resources or use unsuitable financing methods (Eno-Adams, 2018). Understanding these issues can help entrepreneurs choose more effective funding strategies and prepare for common financial challenges.

Second, the study provides empirical evidence from a context that is underrepresented in the literature. Most entrepreneurship research focuses on developed economies (North America, Western Europe, East Asia) or large emerging markets (Brazil, Russia, India, China). Afghanistan represents a different reality: a fragile state with weak institutions, high security risks, and limited financial infrastructure. Findings from this context can inform theories of entrepreneurship under extreme uncertainty (Bruton, Ahlstrom, & Si, 2021).

Third, the findings have practical implications for policymakers and financial institutions. If insufficient personal capital is the main constraint, then policies that facilitate savings mobilization or provide matching grants to start-ups may be effective. Without context-specific evidence, policy interventions risk being ineffective or counterproductive.

Fourth, the study serves an educational purpose. By documenting the financing realities of Afghan start-ups, it can increase financial awareness among young business owners, encourage evidence-based decision-making, and support the development of more resilient enterprises in Balkh province and beyond.

1.5 Research Objectives

Primary Objective: To identify the methods, solutions, and challenges of financing small start-ups in Balkh province, Afghanistan.

Secondary Objectives: (1) To determine the criteria used by financial managers in newly established companies when selecting financing methods. (2) To identify the most suitable and most commonly used financing methods from the perspective of start-up managers. (3) To analyze the major financing challenges faced by newly established companies. (4) To document the coping strategies that start-ups employ when facing financial pressure.

1.6 Research Questions

Main Research Questions:

1. How do newly established companies in Balkh province provide financial resources?
2. What are the major financing challenges faced by newly established companies in Balkh province?

Sub-questions:

1. By what criteria do financial managers of newly established companies prioritize financing methods?
2. What are the most suitable financing methods for newly established companies in Balkh province?
3. How do start-ups in Balkh province manage or reduce their financing challenges?

1.7 Research Hypotheses

Based on the theoretical framework (Pecking Order Theory and Trade-off Theory) and the literature review, the following hypotheses were formulated:

Main Hypotheses:

1. **H1**: Managers of newly established companies in Balkh province primarily rely on personal capital as their financing method, more than would be expected by chance.
2. **H2:** Insufficient personal capital is one of the most significant financing challenges faced by newly established companies in Balkh province.

Sub-hypotheses:

1. **H1a:** Newly established companies in Balkh province prioritize financing methods based on the legality of available sources.
2. **H1b:** The use of the owner's personal capital is preferred over all other financing methods in newly established companies.
3. **H1c:** Newly established companies in Balkh province manage financing challenges by selling company-related assets.

1.8 Research Variables

1. **Independent Variable:** Financing solutions and challenges (including financing methods, selection criteria, and perceived obstacles)
2. **Dependent Variable:** Newly established companies (specifically their survival, activity level, and coping strategies)

1.9 Scope and Delimitations

This study focuses exclusively on newly established companies (operating for less than three years) registered with the Department of Commerce and Industries of Balkh province, Afghanistan. The research does not include informal businesses, sole proprietorships without legal registration, or companies established more than three years prior to data collection. The sample is limited to 30 companies due to access constraints and the exploratory nature of the research; this limits statistical power and the generalizability of findings to all Afghan start-ups (see Section 6.3).

1.10 Structure of the Paper

The remainder of this paper is organized as follows. Section 2 presents the theoretical framework and literature review, including Pecking Order Theory and Trade-off Theory. Section 3 describes the research methodology, including sampling, data collection, and analysis procedures. Section 4 reports the descriptive and inferential results. Section 5 discusses the findings in light of prior literature and theoretical predictions. Section 6 concludes with a summary of findings, theoretical and practical implications, limitations, and directions for future research.

2. Theoretical Framework and Literature Review

2.1 Theoretical Framework

This study is grounded in two complementary theories of corporate finance that explain how firms, particularly start-ups in uncertain environments, make financing decisions.

2.1.1 Pecking Order Theory (Myers & Majluf, 1984)

The Pecking Order Theory posits that firms prioritize financing sources according to a hierarchy based on information asymmetry and transaction costs. The hierarchy is: (1) internal financing (retained earnings, personal capital), (2) debt, and (3) external equity (Myers & Majluf, 1984). The underlying logic is that managers possess superior information about firm value compared to external investors. Issuing equity signals overvaluation, leading investors to discount the share price. To avoid this adverse selection problem, firms prefer internal funds first (Sassi, 2016).

For start-ups, retained earnings are typically unavailable due to the absence of accumulated profits (Pawl, 2011). Therefore, Pecking Order Theory predicts that new ventures will rely primarily on founders' personal capital, followed by debt (e.g., bank loans or informal borrowing), and will avoid external equity unless absolutely necessary. In fragile economies like Afghanistan, where information asymmetry is extreme and legal protections for external investors are weak, this preference for internal financing is expected to be even more pronounced (Saunders, Lewis, & Thornhill, 2019). Recent empirical work supports the continued relevance of Pecking Order Theory for start-ups in emerging and institutionally weak markets: Marimuthu and Singh (2023) confirmed a strong pecking-order pattern among South African start-ups, while Kounouwewa and Azon (2025) found that collateral shortages, informality, and limited financial literacy push African SMEs away from formal debt and toward internal funds a pattern closely mirrored in the present study.

2.1.2 Trade-off Theory (Kraus & Litzenberger, 1973)

The Trade-off Theory suggests that firms balance the tax benefits of debt against the costs of potential financial distress (Kraus & Litzenberger, 1973). An optimal capital structure

exists where the marginal benefit of debt equals the marginal cost of financial distress (Frank & Goyal, 2020).

In the context of Afghan start-ups, the costs of financial distress are exceptionally high due to economic volatility, weak bankruptcy laws, and the absence of social safety nets. High interest rates (reported by 20% of respondents in this study as a major challenge) increase the direct cost of debt. Furthermore, the risk of asset confiscation in case of default, particularly in a weak institutional environment, elevates the indirect costs of financial distress. Trade-off Theory therefore predicts that start-ups in such contexts will exhibit low debt utilization, a prediction tested in this study.

2.1.3 Synthesis for the Present Study

The two theories offer complementary predictions:

1. From Pecking Order Theory: Afghan start-ups will prioritize personal capital over bank loans.
2. From Trade-off Theory: High costs of financial distress (including high interest rates and legal risks) will further discourage debt usage.

Together, these theories provide the analytical lens for interpreting the financing behavior observed in Balkh province.

2.2 Literature Review

2.2.1 Financing Patterns in Start-ups

A substantial body of literature confirms that start-ups globally rely heavily on founder capital. Eno-Adams (2018) studied technology start-ups and found that limited access to capital restricts growth, weakens performance, and prevents market expansion. The study concluded that founders must manage resources effectively until positive cash flow is achieved, a pattern broadly aligned with the internal-financing preference described in Pecking Order Theory.

Miloud, Aspelund, and Cabrol (2012) examined venture capital valuation and demonstrated that start-up valuation difficulties lead to over-reliance on owner financing in early stages. Their empirical study of 112 European start-ups found that the absence of historical financial data forces entrepreneurs to rely on personal networks and internal funds. Similarly, Gompers and Lerner (2021) documented that the "venture capital revolution" has largely bypassed small start-ups in developing economies, where angel investors and formal risk capital remain scarce.

2.2.2 Financing in Emerging and Fragile Economies

Research specifically addressing financing in fragile economies is limited but growing. Bruton, Ahlstrom, and Si (2021) studied entrepreneurship in conflict-affected regions and found that weak legal frameworks, high inflation, and unstable banking systems push entrepreneurs toward informal financing sources, including family savings, in some

contexts, and rotating savings clubs. While rotating savings clubs are not yet documented in the Afghan literature specifically, informal community-based lending arrangements share similar characteristics and warrant further investigation in this setting. Kerr and Nanda (2022) noted that in environments with weak creditor rights, debt financing becomes prohibitively expensive, reinforcing the Pecking Order hierarchy.

In the Middle Eastern and South Asian context, Karimi (2013) analyzed small and medium-sized enterprises (SMEs) in Iran and found that conventional, interest-based bank loans ranked highest among financing options, a finding that partially contradicts the present study's expectations. This discrepancy likely reflects institutional differences: Iran has a more developed banking sector, lower perceived political risk, and government-subsidized interest rates for SMEs. By contrast, Afghanistan's banking sector remains fragile following political transitions (World Bank, 2023). This reliance on interest-based lending in Karimi's (2013) sample should be interpreted with caution, as Islamic financing alternatives such as musharakah, mudarabah, and murabahah were not examined in that study but merit consideration in future Afghan research. This concern is directly supported by more recent Afghanistan-specific evidence: Ahmad and Kaur (2025), analyzing SMEs across Afghan cities, found that external finance had little impact on firm innovation precisely because most firms avoid bank loans both due to onerous collateral and administrative requirements and because interest (riba) is prohibited under Islamic principles, leading firms to rely overwhelmingly on internal finance. This finding closely parallels the present study's results on the dominance of personal capital.

Abzari (2007) examined Tehran Stock Exchange-listed companies and reported a significant relationship between financing structure and firm size: larger firms rely more on retained earnings. However, for start-ups, retained earnings are typically unavailable (Abzari, 2007), making personal capital the default option. This size-financing relationship suggests that as Afghan start-ups grow, their financing mix may shift a hypothesis for future longitudinal research.

2.2.3 Financing Challenges and Coping Strategies

Eno-Adams (2018) identified insufficient personal capital as the most critical barrier for technology start-ups, a finding echoed in the present study. Sassi (2016) proposed an integrated valuation model for social-media start-ups, arguing that traditional finance inputs are absent in early-stage ventures. This supports the notion that unconventional methods, including personal capital and informal borrowing, dominate when formal institutions are weak.

Regarding coping strategies, research on business failure (Shepherd, 2021) suggests that firms facing financial pressure may adopt defensive strategies (cost reduction, activity reduction) or proactive strategies (diversification, seeking new

investors). The choice depends on founder characteristics, perceived self-efficacy, and the availability of alternative funding sources (World Bank, 2023).

3. Methodology

3.1 Research Design

This study employed a descriptive, cross-sectional, applied quantitative research design. The descriptive design was appropriate because the objective was to systematically describe the financing methods, challenges, and coping strategies of newly established companies as they naturally exist, without manipulating any variables (Saunders, Lewis, & Thornhill, 2019). The cross-sectional element reflects the fact that data were collected at a single point in time and therefore capture financing behavior at that moment rather than tracking change over time. The applied nature of the research reflects its practical orientation: the findings are intended to inform entrepreneurs, policymakers, and financial institutions rather than merely contribute to theoretical knowledge (Hair, Black, Babin, & Anderson, 2021).

A quantitative approach was adopted, using a structured questionnaire to collect primary data. This approach supports hypothesis testing and provides a basis for cautious statistical inference; however, given the sample size (N = 30) relative to the sampling frame (87 companies), generalization to the broader population of Afghan start-ups should be made with care (Wakili Fard, 2011).

3.2 Population and Sampling Frame

Target Population: The target population comprised all newly established companies in Balkh province, Afghanistan. For the purpose of this study, "newly established" was operationally defined as companies that had been operating for less than three years from the date of data collection. This definition aligns with standard entrepreneurship literature, which distinguishes start-ups (0-3 years) from established SMEs (Karimi, 2013).

Sampling Frame: The sampling frame was obtained from the Department of Commerce and Industries of Balkh province. According to the department's registry, 87 companies met the criteria of being newly established (less than three years old) and actively registered at the time of the study.

Sample Size: Using random sampling, 30 companies were selected from the sampling frame of 87. A sample size of 30 is acceptable for exploratory descriptive studies, particularly in hard-to-reach research contexts such as fragile states (Cohen, 1988). Nonetheless, this sample size limits statistical power and the extent to which findings can be generalized to all newly established companies in Afghanistan; this limitation is discussed further in Section 6.3.

Sampling Procedure: A simple random sampling method was employed. Each of the 87 companies in the sampling frame was assigned a unique number from 1 to 87.

Using a random number generator (Microsoft Excel RANDBETWEEN function), 30 unique numbers were selected. The managers or owners of the corresponding companies were then invited to participate.

3.3 Data Collection Instrument

A structured questionnaire was developed as the primary data collection instrument, designed based on:

1. The research objectives and hypotheses formulated in Section 1.
2. The theoretical framework (Pecking Order Theory and Trade-off Theory).
3. A review of prior empirical studies on start-up financing (Karimi, 2013).

3.4 Validity and Reliability

3.4.1 Validity

1. **Content Validity:** The questionnaire items were reviewed by three independent experts: two finance faculty members from Balkh University and one business advisor with experience in Afghan start-ups. Experts assessed whether each item adequately measured the intended construct. Based on their feedback, minor wording changes were made to improve clarity and cultural appropriateness.
2. **Face Validity:** A pilot test was conducted with five start-up managers who were not included in the final sample. The pilot participants confirmed that the questions were clear, relevant, and easy to understand. No major changes were required following the pilot.

3.4.2 Reliability

Reliability refers to the internal consistency of the questionnaire- the extent to which items measuring the same construct produce similar responses (Nunnally & Bernstein, 1994).

1. **Cronbach's Alpha:** Internal consistency was assessed using Cronbach's alpha coefficient. The questionnaire yielded a Cronbach's alpha of $\alpha = 0.78$, which exceeds the acceptable threshold of 0.70 recommended by Nunnally and Bernstein (1994). This indicates acceptable internal consistency.

Table 1: Cronbach's Alpha Reliability Coefficient for the Questionnaire

Questionnaire	Number of Items (k)	Cronbach's Alpha (α)	Reliability Level
Total questionnaire	15	0.78	Acceptable

Source: Research finding

Test-Retest Reliability: To assess stability over time, the questionnaire was administered twice to the same five pilot participants with a two-week interval. The correlation between the two administrations was $r = 0.85$, indicating good temporal stability.

4. Results

4.1 Descriptive Statistics

Table 2: Demographic Characteristics of Sampled Companies (N = 30)

Characteristic	Category	Frequency	Percentage
Legal structure	Limited liability company	21	70%
	Partnership	6	20%
	Sole proprietorship	3	10%
Type of activity	Production	18	60.0%
	Service	7	23.3%
	Mixed	5	16.7%
Financial manager	Yes	30	100%

Source: Research finding

Table 3: Summary of Descriptive Findings (N = 30)

Variable	Category	n	%
Financing method	Personal capital	24	80%
	Bank loans	6	20%
Selection criterion	Legality	18	60%
	Low interest rate	6	20%
	Quick access	3	10%
	Economic efficiency	3	10%
Main challenge	Insufficient personal capital	18	60%
	High interest rates	6	20%
	No challenge	6	20%
Coping strategy	Reduce activities	18	60%
	Diversify resources	6	20%
	Sell assets	3	10%
	Social assistance	3	10%

Source: Research finding

The questionnaire captured this preference through a single combined item asking respondents to identify their preferred and least-risky financing method together, rather than through two separately scored items; all 30 respondents (100%) selected personal capital on this combined item. Because "best" and "least risky" were not measured as independent constructs, it is not possible to determine whether respondents would have rated them differently if asked separately (for example, a method could plausibly be seen as low-risk without being considered the single best option for growth). Future revisions of the instrument should separate these two dimensions into distinct items so that each can be reported and tested independently.

4.2 Inferential Statistics (Hypothesis Testing)

To test the research hypotheses, exact two-tailed binomial tests were conducted (recalculated from the raw frequencies using the exact binomial distribution). The null

hypothesis (H_0) for each test stated that the observed proportion equals 0.50 (no majority preference). The alternative hypothesis (H_1) stated that the observed proportion differs significantly from 0.50. A test proportion of 0.50 was chosen because each hypothesis asks whether a single category (e.g., personal capital, legality, asset sales) was favored by a majority of respondents rather than occurring by chance; 0.50 is therefore the natural neutral benchmark for a two-outcome majority question (favored the category vs. did not). Where a variable had more than two response categories (e.g., the four selection criteria in Table 3), the binomial test was applied to the single largest category versus all others combined, which addresses whether that category constitutes a majority; it does not test whether the categories are equally distributed. For that latter question, a chi-square goodness-of-fit test would be more appropriate, and future studies with larger samples should consider it as a complement to the binomial approach used here. Significance level: $\alpha = 0.05$.

Table 4: Hypothesizes testing (N = 30)

Hypothesis	Description	Observed Proportion	p-value (2-tailed, exact)	Decision
H1	Personal capital as primary financing method (vs. all other methods)	80% (24/30)	p = 0.001	Supported
H2	Insufficient personal capital is main challenge	60% (18/30)	p = 0.362	Not supported
H1a	Legality is primary selection criterion	60% (18/30)	p = 0.362	Not supported
H1b	Personal capital is preferred method	100% (30/30)	p < 0.001	Strongly supported
H1c	Selling assets to manage challenges	10% (3/30)	p < 0.001	Rejected (proportion significantly below 50%)

Source: Research finding (recalculated using the exact binomial test)

Interpretation of Binomial Test Results:

1. H1 (p = 0.001): The proportion of companies relying primarily on personal capital (80%) significantly exceeds 50%, confirming personal capital as the dominant financing method relative to bank loans.
2. H2 (p = 0.362): Although 60% of respondents identified insufficient personal capital as the main challenge, this proportion does not differ significantly from 50%. The null hypothesis cannot be rejected; H2 is therefore not statistically supported, despite being the most frequently cited challenge descriptively.
3. H1a (p = 0.362): Similarly, the 60% preference for legality as the primary selection criterion does not reach statistical significance in this sample. H1a is

not supported.

4. H1b ($p < 0.001$): The unanimous preference for personal capital (100%) is highly significant.
5. H1c ($p < 0.001$): The proportion of firms selling assets (10%) is significantly lower than 50%. The null hypothesis is rejected, confirming that asset sales are not a common coping strategy.

4.3 Summary of Key Statistical Findings

Table 5: Summary of Key Statistical Findings

Finding	Statistical Result
Personal capital is the dominant financing method	80%, $p = 0.001$
Personal capital is the most preferred method	100%, $p < 0.001$
Legality is a frequently cited selection criterion, but not statistically confirmed as the majority preference	60%, $p = 0.362$ (not significant)
Insufficient personal capital is the most frequently cited challenge, but not statistically confirmed as the majority view	60%, $p = 0.362$ (not significant)
Asset sales are not a common coping strategy	10%, $p < 0.001$

Source: Research finding

5. Discussion

5.1 Interpretation of Findings

The findings are consistent with Pecking Order Theory (Myers & Majluf, 1984): start-ups prioritize internal financing (personal capital, 80%) over debt (bank loans, 20%), and this proportion is statistically significant ($p = 0.001$). The unanimous preference for personal capital as the "least risky" method suggests a strong preference for low-risk financing among Afghan start-up managers, though this study did not directly measure risk aversion as a psychological construct, and this interpretation should be treated as suggestive rather than confirmed.

Descriptively, 60% of respondents prioritized the legality of the financing source; however, this proportion did not differ significantly from 50% ($p = 0.362$), so this pattern should be treated as a notable descriptive trend rather than a statistically confirmed preference. Given Afghanistan's weak institutional environment, the salience of legality as a criterion - even without reaching statistical significance in this sample — merits further investigation with a larger sample. It is also worth noting that legality of a financing source is not equivalent to its compliance with Islamic principles (halal status); a source can be legal under Afghan commercial law while still involving interest (riba), which is prohibited in Islam. Future revisions of the instrument could usefully distinguish these two criteria.

The rejection of H1c confirms that selling assets is not a common coping strategy ($p < 0.001$); asset sales occurred significantly less often than would be expected by chance.

Descriptively, 60% of respondents instead reported reducing business activities, though this proportion also did not reach statistical significance against the 50% benchmark ($p = 0.362$) and should be read as a descriptive pattern. Taken together, these patterns suggest - as a possible interpretative framework rather than a statistically tested causal chain- a "financing trap": capital scarcity may lead to activity reduction, which may lower profits and perpetuate capital scarcity. Testing this causal chain directly is left for future longitudinal research.

5.2 Comparison with Prior Literature

Table 6: Comparison of Findings with Prior Literature

Study	Key Finding	Comparison
Eno-Adams (2018)	Insufficient capital restricts growth	Broadly consistent (descriptive)
Karimi (2013)	Interest-based bank loans common for Iranian SMEs	Inconsistent (reflects institutional and, potentially, Islamic-finance differences)
Miloud, Aspelund, & Cabrol (2012)	Start-ups rely on owner financing	Consistent
Ahmad & Kaur (2025)	Afghan SMEs avoid bank loans due to collateral barriers and riba prohibition	Consistent

Source: Research finding

5.3 Practical Implications

1. **For entrepreneurs:** Seek financial literacy training and explore microfinance and Shariah-compliant financing alternatives.
2. **For policymakers:** Establish loan guarantee schemes and Shariah-compliant micro-financing mechanisms.
3. **For banks:** Design start-up-specific products with flexible, and where possible, Shariah-compliant repayment structures.

6. Conclusion

6.1 Summary of Findings

This study investigated the financing solutions, challenges, and coping strategies of newly established companies in Balkh province, Afghanistan. Based on data collected from 30 start-ups and analyzed using descriptive statistics and binomial tests, several key findings emerged.

First, regarding financing methods, personal capital was the dominant source, used by 80% of respondents, while bank loans accounted for only 20% ($p = 0.001$). This finding is consistent with Pecking Order Theory (Myers & Majluf, 1984), which predicts

that firms prioritize internal financing over external debt, particularly in contexts characterized by high information asymmetry and weak institutional protections.

Second, concerning financing preferences, all 100% of respondents identified personal capital as both the "best" and the "least risky" financing method ($p < 0.001$). This near-unanimous preference suggests a strong orientation toward low-risk financing among Afghan start-up managers.

Third, regarding selection criteria, 60% of respondents prioritized the legality of the financing source over other factors such as interest rates or speed of access; however, this proportion did not reach statistical significance ($p = 0.362$) and should be treated as a descriptive trend. It nonetheless indicates that institutional context may matter: in a fragile state with weak legal protections, the risk of sanctions from using illegal sources may weigh on financing decisions, though a larger sample is needed to confirm this statistically.

Fourth, insufficient personal capital was the most frequently cited financing challenge, reported by 60% of respondents; however, this proportion did not differ significantly from 50% ($p = 0.362$), and so this finding should be interpreted as a descriptive trend rather than a statistically confirmed majority pattern. Descriptively, it nonetheless points to a fundamental tension: start-ups need capital to grow, but their primary capital source (personal savings) is precisely what respondents most often described as insufficient. This study terms this pattern a "financing trap": capital scarcity may lead to activity reduction, which may lower profits and in turn perpetuate capital scarcity — though this causal chain was not directly tested and should be treated as an interpretative framework for future research.

Fifth, regarding coping strategies, 60% of respondents reported reducing business activities when facing financial pressure (a descriptive pattern not reaching statistical significance, $p = 0.362$), while only 10% sold company assets. The hypothesis that firms manage financing challenges by selling assets (H1c) was rejected, as this proportion was significantly lower than 50% ($p < 0.001$).

In summary, the financing decisions of newly established companies in Balkh province appear to be shaped by resource availability, perceived risk, and a strong reliance on owner-based financing, though not all descriptive patterns reached statistical significance in this small sample. The Afghan start-up ecosystem may operate within a financing trap in which limited capital reinforces conservative, low-growth strategies -a proposition that merits direct testing in future, larger-sample research.

6.2 Recommendations

Based on the findings of this study, the following recommendations are offered for four distinct stakeholder groups.

Entrepreneurs should seek financial literacy training to learn about alternative financing mechanisms beyond personal capital and bank loans. Exploring community-

based rotating savings arrangements — distinct from hawala, which is primarily a money-transfer system rather than a savings mechanism — could provide access to small-scale, low-risk funding, though the prevalence of such arrangements among Afghan start-ups was not directly measured in this study. Additionally, building networks with other business owners may open informal financing opportunities such as joint ventures, supplier credit, or peer-to-peer lending. Rather than automatically reducing activities when facing financial pressure, entrepreneurs should consider small-scale diversification to generate additional cash flow.

Policymakers should establish government-backed loan guarantee schemes to reduce banks' perceived risk when lending to start-ups. Rather than interest-based subsidies, policymakers could support Shariah-compliant financing mechanisms for start-ups in priority sectors (such as production and agriculture) — including qard al-hasan (benevolent loans), musharakah (partnership), mudarabah (profit-sharing), and murabahah (cost-plus financing) — to help overcome the initial financing barrier in a manner consistent with Islamic financial principles. Given that 60% of respondents prioritized legality (though this proportion did not reach statistical significance in this sample), policymakers should also launch clear, accessible information campaigns about legal — and, ideally, Shariah-compliant — financing sources and the risks of informal alternatives. Finally, pilot micro-venture capital funds targeting high-potential start-ups should be considered as a way to introduce risk capital into the ecosystem.

Banks and other financial institutions should design start-up-specific loan products with flexible repayment schedules, including grace periods and revenue-based repayments that accommodate the irregular cash flow patterns typical of new ventures. Given that many start-ups lack physical assets for collateral, institutions should explore non-collateral lending mechanisms such as peer guarantees, group lending, or cash-flow-based lending, alongside Shariah-compliant products. Partnering with universities and business associations to offer financial literacy workshops would also help prepare start-ups for formal credit.

Future research should replicate this study in other Afghan provinces (such as Kabul, Herat, and Kandahar) with larger sample sizes ($N > 100$) to enable comparative analysis and more sophisticated inferential statistics. Researchers should employ mixed methods, combining surveys with semi-structured interviews (10-15 entrepreneurs) to explore the reasons behind bank loan avoidance and the preference for activity reduction over asset sales. Longitudinal studies that follow the same start-ups over 12-24 months would help track how financing strategies evolve as firms grow and economic conditions change.

6.3 Limitations and Future Research

This study has several limitations that should be acknowledged. The sample size was small ($N = 30$), which limits statistical power and generalizability to all Afghan start-ups;

the modest sample size meant that some descriptively notable patterns (e.g., the 60% reporting insufficient personal capital as the main challenge) did not reach conventional levels of statistical significance — a limitation that larger future samples could address. The study was confined to a single province (Balkh), so findings may not represent other Afghan provinces such as Kabul, Herat, or Kandahar, which have different economic conditions and banking infrastructures. The cross-sectional design captured financing behavior at only one point in time and cannot track how financing strategies evolve as firms grow. Additionally, the reliance on self-reported data may introduce social desirability bias, such as underreporting of informal loans. Finally, the absence of a qualitative component means the study can describe what start-ups do but cannot fully explain why they prefer certain strategies.

These limitations point to several directions for future research. First, larger, multi-province studies with samples exceeding 100 start-ups would enable more robust statistical analysis and regional comparisons. Second, mixed-methods research that combines surveys with semi-structured interviews would provide deeper insights into the reasoning behind financing decisions. Third, longitudinal designs that follow start-ups over time would reveal how financing strategies change with firm growth and economic fluctuations. Fourth, comparative studies examining start-ups across multiple fragile states (such as Afghanistan, Yemen, and Somalia) would help identify which challenges are context-specific and which are common to fragile economies generally. Fifth, the role of financial literacy as a moderating variable between financing challenges and coping strategies deserves investigation. Finally, gender analysis examining whether male-owned and female-owned start-ups face different financing constraints would be valuable for designing targeted policy interventions, as would a dedicated investigation of Shariah-compliant financing uptake and preferences.

6.4 Final Remarks

This study provides empirical evidence on start-up financing in Balkh province, Afghanistan, and is among the first studies to examine this topic in the Afghan context. The findings reveal a context where personal capital dominates, bank loans are underutilized, and financial pressure appears to be associated with contraction rather than innovation. The concept of a "financing trap" — where capital scarcity may reinforce conservative, low-growth strategies — captures a plausible core challenge facing Afghan start-ups, though this relationship requires direct testing in future research. Breaking this pattern will likely require coordinated action from entrepreneurs, policymakers, and financial institutions. By documenting the current realities of start-up financing, this study provides a baseline for measuring future progress and a foundation for evidence-based policy interventions in fragile economies.

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